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Inside Ukraine

August 28, 2014
Nº25

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The Government Policy

The militants' counter-offensive on ATO positions was intended to weaken the position of Ukraine on the eve of negotiations in Minsk. It became possible thanks to the Russian soldiers and weapons supplies, which was organized in parallel with sending of a humanitarian convoy. Another function of this special operation was transfer of equipment of the Ukrainian military-industrial complex to the Russian territory. Enterprises of the military industrial complex are particularly valuable for Moscow due to the plans to modernize its own army. Russia is trying to exasperate national

animosity between eastern and western Ukraine using the separatists' actions so that the conflict in Donbas will become a permanent hotspot.

Clients of Ukrainian banks are uniting in civic initiatives in order to counteract the banking lobby. After a dramatic devaluation of the hryvnia, depositors find themselves in a difficult situation. The deterioration of Ukrainian banks' solvency has led to the situation when even term deposits are not reimbursed. The NBU does not take active steps as regards maintaining FX rate and protecting banks' clients. It caused a sharp criticism of Mrs. Valeria Hontariva.

Separatists' actions are aimed at weakening the position of Ukraine in negotiations



The number of Russia's military equipment and servicemen on the territory of Ukraine is increasing to a greater extent. Using a humanitarian convoy for distraction, Moscow greatly reinforced militants' groups in Donetsk and Luhansk regions. Thus, separatists got the

Militants' counter-offensive with the support of Russian troops created a threat for ATO forces to be encircled

resources for counter-offensive on the positions of the Ukrainian forces. As a result, progress in liberation of Donbas, made by the Ukrainian army, has been suspended, and some ATO units even face a threat of encirclement.

Before the multilateral talks in Minsk in the format "EU-Ukraine-Eurasian three", it was in the interests of Moscow to demonstrate success of separatists as regards regaining territory controlled by

Ukrainian forces. It would weaken Ukraine's position in negotiations and raise the issue of recognizing the separatists as an independent party in the conflict. However, this goal has not been achieved until August 26 (the day when Minsk talks took place) due to resistance of the Ukrainian military.

The fact that every week Russia crosses another red line in its aggression against Ukraine indicates a clear message to Western countries about Vladimir Putin's readiness to further escalation of the situation. At first, Russia aided in providing weapons and instructors, then — Russian artillery shelled Ukrainian territory from Russia, and now — entire regular army units and columns of Russian military equipment are transferred to Ukraine.

In view of the fact that Russians opened the second front in the south of Donetsk region, even representatives of the United States and Sweden officially recognized that Russia began military invasion. According to the head of the Union of Soldiers' Mothers Committees of Russia, Mrs. Valentyna Melnykova, at least 15 thousand of Russian soldiers are fighting in Ukraine.

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Putin's humanitarian convoy turned out to be a multifunctional special operation. In addition to diverting the world's attention from the main routes for weapons supplies from Russia and creating a positive TV image, a convoy of 280 trucks was used to transfer equipment of Ukrainian military enterprises in Donetsk and Luhansk to the RF.

According to some analysts, a dozen of enterprises of the Ukrainian military industrial complex are of much greater importance for Russia than the Crimea annexation. They are located in the south and east of the country that corresponds to the geography of the Kremlin's project "Novorossiia". Without these enterprises, Russia fails to modernize its army and restore country's military power necessary to compete with the United States. The fact that the Russians have taken equipment out of Donetsk plants indicates that Moscow does not exclude the possibility of losing separatists' control over Donetsk, Luhansk and Snizhne.

Removal
of equipment
from military
plants indicates
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of the Russian
aggression
against Ukraine

However, such a conduct reveals the true motives of Russian aggression against Ukraine, as well as possible points of negotiation package between the two countries.

Moscow continues its attempts to manipulate public sentiment in Ukraine through separatists' actions. A few weeks ago, militants were massively uploading videos of Ukrainian army losses to the web in order to spread panic among the population and to demonstrate that the real losses of ATO forces are much higher than the official statistics.

The next step was a video about separatists' humiliation over pro-Ukrainian citizens with an active involvement of the local Donbas population. For example, on the Independence Day of Ukraine, separatists organized a "march of hate", during which they demonstrated a few dozen of Ukrainian war prisoners marching in the streets of Donetsk. Moreover, several thousand of local residents approvingly watched this demonstration. On August 26, the world's leading media shared snapshots how the local people have bullied over the woman roped to a "pillory" because of her supposed assistance to the Ukrainian army. These episodes indicate a desire to increase the degree of tension between East and West of Ukraine.

The Kremlin cannot "sow grapes of wrath" among Ukrainians through controlled media (practice that is successfully used by Russia for its own population), and therefore is actively producing episodes designed for public response and strong emotional impact on the target audience in Ukraine.

While the early confrontation developments in Donbas was artificially inspired from the outside, with an increase of victims number, the Russian scenario to deepen the split between Donbas and the rest of Ukraine will lead to an exacerbation of the civil conflict with its smoldering without outside interference. Ukraine can counteract this scenario through establishing direct communication between West and East of the country, which would initiate a national dialogue.

Using separatists'
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«Currency unrest» as a result of the NBU inaction

Drastic devaluation of hryvnia and the NBU inaction in supporting the national currency becomes a strong factor that increases tension in the society. With UAH depreciation, purchasing capacity of citizens deteriorates. It will get even worse since October 2014, when utility prices surge.

The NBU inaction in supporting the national currency increases tension in the society

UAH devaluation will have a direct influence on customers of banking sector. Depositors who have FX deposits are unable to receive their money as the banks claim that there is no foreign currency in their cash desks. However, borrowers who got FX loans are obliged to repay the loan under a new FX rate, which continues increasing. There are frequent cases when the penalty for overdue is higher than the loan principal. Quite often, the borrowers cannot settle the issue with the bank even though they repaid interest amount which exceeds the principal as of the financing date manifold.

Currently we have the situation when some banks do not return term deposits not only in USD, but also in UAH for more than 6 months. The deposit amount is channeled to correspondent account, but clients cannot withdraw these funds as a bank introduces limits on cash withdrawal (for instance, VAB bank does not allow to withdraw more than UAH 1000 (equivalent of USD 70) per day, though the NBU set the limit of UAH 15000 per day). Quite often, the banks do not fulfill even such meager limits, but the National bank turns a blind eye on violations of this kind.

The National bank turns a blind eye on banks not returning term deposits

In order to protect their interests, individuals who have to repay FX loans, but receive income in UAH created NGO "Credit Maidan". On August 21, 2014 several hundreds of its representatives picketed the National bank. They also appealed to bank customers who have UAH loans and depositors to whom the banks do not return their funds, to join the picket. Consolidation of all the three categories is highly unlikely due to different nature of their

claims, but active protest of banking clients as regards protection of their property rights may transform into a full-scale movement.

Protection of property rights by banking clients may transform into a full-scale movement

Bankers claim that the compromise may be reached to solve the issue, when FX loans are converted in UAH under fixed interest rate and without any additional charges on the part of banks. Currently the law forbids the bank to take mortgage property from borrowers who have FX loans and to sell credit files of borrowers to the third party. Representatives of the banking industry promote the provision when all the exposure may be repaid after the mortgage object is returned, even if its current value is lower than the exposure amount. Head of the NBU assured that in case Verkhovna Rada approves such a draft law, the National bank will do all the procedures within its competence.

It was on August 12, 2014, when Valeria Hontariva, head of the National bank, was asked to report to Verkhovna Rada on record-breaking fall of the national currency. At that time FX rate was UAH 13-13.5 per dollar. Ms. Hontariva claimed that there were no economic reasons for such fall and that justified FX rate was UAH 11.5-11.9, even in case hostilities in the East were considered. After the parliamentary speech of the NBU head positions of Ukrainian currency became stronger, but only for few days. On August 26-27, the national currency broke its record level for few times when FX rate became UAH 14-14.5 per dollar. Meanwhile, PM Arseniy Yatseniuk believes that Ukrainian economy will not put up with the FX rate higher than UAH 12 per dollar. He said that the government was ready to help the National bank to stabilize the rate.

Hryvnia continues record-breaking fall

If the NBU keeps ignoring situation with banks and FX rate, it will undermine citizens' trust to banking sector and national currency, as well as it will influence the inflation rate.

Economic Situation

Government presented deregulation reform which foresees a drastic decrease in the number of permits, licenses and regulations. One of its features is use of online platform to discuss it with the public, to introduce suggestions and to track its implementation. A significant drawback of the reform is that it modernizes the existing system, while it does not create an essentially new regula-

tory system of the market type.

Government is going to establish Financial Investigations Service. A respective draft law was registered in Verkhovna Rada by State Fiscal Service, which defines legal framework for fight and prevention of economic crimes, ensuring economic security of Ukraine and securing its financial potential.

Government elaborated deregulation reform



Presidential Administration, together with Ministry of Economic Development and Trade, elaborated concept of deregulation — the way how regulatory policy should be reformed. Civic activists, business representatives and experts participated in elaboration of the concept. One of its features is use of online platform to discuss the reform, make suggestions and track its implementation. Regardless of its scale, the re-

The public will have an opportunity to participate in the reform elaboration

form does not provide for creation of a new regulatory system based on market economy principles.

Its aim is to facilitate business, decrease costs for entrepreneurs, and improve Ukraine's position in Doing Business rating. While elaborating the deregulation strategy, expert group interviewed around 100 organizations and analyzed over 1000 regulatory restrictions.

The concept provides for cancellation of permits, decrease of inspection frequency, liquidation of entire units and state regulatory bodies (in particular, the number of controlling bodies will decrease

from 79 to 32). It contains over 800 initiatives on deregulation.

In order to involve all the stake-holders in the reform discussion, a special online platform (www.easybusiness.in.ua) is created. Information on the web resource will not only provide overview of the initiatives proposed, but it will help to track their implementation by state agencies. The suggestions are classified according to the industries and regulatory sectors. The web-site also provides an opportunity to propose an idea to experts.

The authors expect that overall economic effect of the strategy implementation will make up around UAH 170 bln. by 2020 .

Expected economic effect as per industries will be around UAH 85 bln., decrease in dirty cash flows — around UAH 60 bln., in budget expenses — UAH 16 bln. In particular, it will include:

- deregulation in food industry aimed to adapt industrial processes to the EU standards (economic effect — UAH 30 bln., dirty cash flows will decrease approximately by UAH 7 bln.)
- deregulation in agricultural sector is aimed at fight against corruption and export stimulation (economic effect — around UAH 10 bln., decrease in corruption component — around UAH 7 bln.);

The authors expect that overall economic effect of the strategy will make up UAH 170 bln. by 2020

- deregulation in construction industry is aimed to improve Ukraine's position in Doing Business rating and eliminate corruption (economic effect — UAH 16 bln., decrease in corruption component — UAH 21 bln.);
- in oil and gas industry the focus is on building up domestic extraction of oil and gas and decreasing dependence on the Russian supplies (expected economic effect and decrease in corruption component is UAH 11 bln. each).

Deregulation is extremely important reform in terms of making legal framework for doing business more transparent. It also improves investment and business climate. It is noteworthy that the authors of the reform did their best to ensure maximum transparency of its elaboration and implementation through the use of the online platform.

Yet, the ultimate goal of the reform should not be a drastic decrease in the number of various permits (in order to do it, more than 800 amendments to various legislative bills are needed). The aim of the reform should be complete abolishment of the Soviet permit system and creation of a new regulatory system based on the principles of market economy

The aim of the reform is to create a new regulatory system based on market economy standards

Government proposes establishing Financial Investigations Service

Ukrainian Government proposes establishing Financial Investigation Service (financial police), which will comprise five law enforcement agencies: tax police, state financial inspection service, and departments within the Ministry of Internal Affairs and Security Service of Ukraine. The new agency will conduct operational and investigation

The positive effect about creation of Financial Investigations Service is that it helps to avoid duplication of functions in the fight against economic crimes

activities as well as pre-judicial inquiry in the sphere of prevention of and fight against economic crimes. The relative draft law “On the principles of prevention of and fight against economic crimes” has been registered in Verkhovna Rada of Ukraine.

The positive outcome of the establishment of Financial Investigation Service is that it will help to avoid duplication of functions performed by different institutions in the fight against economic crimes. In the first place, this may decrease public expenses and increase the effectiveness of those institutions. The said practice is applied in many countries: the USA, Great Britain, Austria, Italy, Georgia etc.

Another positive outcome is that, according to the State Fiscal Service, the proposals from business were taken in consideration in the process of the draft law elaboration. In particular, the draft law provided for the removal of the audit function. Control activities may be conducted only within pre-judicial inquiry. The control over internal audit of public funds use will be exercised after criminal proceedings are initiated.

Public council under the Financial Investigations Service will play an important role in the new agency. It will have authorities to put forward proposals for draft laws and conduct anti-corruption expertise. This collective body will also have the right to initiate the process of reporting by the head of the public council to Verkhovna Rada and the Cabinet of Ministers as to the results of their work.

One of the problematic moments of this draft law is the discrepancy between the title of the draft law and the subject of its regulation, as well as a rather general description of the Service main functions, and a great number of legal acts, which the Cabinet of Ministers will have to elaborate in the future.

A big number of legal acts to be elaborated by the government threatens implementation of the initiative

The most controversial issue is how the Financial Investigation Service will select its employees and what principles of cooperation with business will be applied. The Financial Investigations Service officers should have sufficient experience in economic and legal activities. The most important criterion for them is having no links to corruption schemes and the way tax police deals with business. The basic principles of the Service functioning should be transparent to avoid corruption and lessen the pressure on business. This is exactly what business expects from the Ukrainian authorities.

The creation of the Financial Investigations Service was not among the EU requirements. Yet, it is needed in view of obligations which Ukraine assumed in the context of the EU-Ukraine Association Agreement. In the first place, this regards the enhancement of fight against tax fraud and tax evasion. The fulfilment of obligations is possible through a special body, the principal activity of which will be aimed at prevention of and fight against economic crimes.

The creation of the Financial Investigations Service was not among the EU requirements

Political competition

As expected, on August 25, 2014 Ukrainian President dissolved Verkhovna Rada, which allowed him to call for early parliamentary elections on October 26, 2014. The main political players are now holding negotiations to form alliances in order to reinforce their positions at the elections. Almost all political parties declare their renewal through launching party lustration and inclusion of civic activists and public opinion makers in party list.

However, such steps are of a technological nature and do not bring about any qualitative changes in politics, which would generate new meanings and ideas as to the transformation of Ukraine according to the European standards. All party efforts are directed towards enhancing attractiveness of party list for voters. Political parties will be also concentrated on choosing the right ally with whom to build a successful electoral campaign.



President's initiative to decide on the coalition design before the elections

On August 27, 2014 the congress of "Solidarity" party took place. "Solidarity" was renamed as "The bloc of Petro Poroshenko". Yuriy Lutsenko became the party leader. Petro Poroshenko, who also attended the congress of "Solidarity", stressed the need for a transparent formation of electoral lists as well as determining the format of potential coalition prior to the parliamentary elections.

The direct allies of «The bloc of Petro Poroshenko» are UDAR and

It is still unclear if "The bloc of Petro Poroshenko", UDAR and the group of Yatseniuk-Turchynov will take part in the elections separately or together

the group of Yatseniuk-Turchynov. However, it is still unclear if formally these political parties are going to join the pro-presidential party, or participate in the elections separately.

According to some journalists, there was another scenario according to which each group could get one third of the party list. Arseniy Yatseniuk is the one who would benefit from this scenario most, as his group is currently balancing on the verge of electoral threshold. It means that he may count 15 MP seats maximum if he participates in the elections separately. On the other hand, one third of the pro-presidential party list as well as the possibility to agree candidates in single-member constituencies would double the number of his

mandates. Yatseniuk's name in the list would prevent Poroshenko from receiving electoral bonuses for his ratings, but administrative influence of the Cabinet of Ministers on electoral campaign should not be underestimated.

Petro Poroshenko's statement that 25 % of the seats won by the bloc at the elections will go to UDAR members indicates that Poroshenko has taken a pragmatic stance on this issue. It is less than 50% of seats Petro Poroshenko promised to Vitali Klitschko for UDAR's support at

Petro Poroshenko took a pragmatic stance on arranging the party list

the presidential campaign. It is also less than one third of the party list which was agreed on when the mega-bloc of Poroshenko-Yatseniuk-Klitschko was discussed. Given such combination, Vitali Klitschko will be much more interested in UDAR running for elections separately, with subsequent inclusion in pro-presidential majority, but after candidates in single-member constituencies are agreed on in order to avoid vote splitting.

At present, electoral support for Poroshenko, Klitschko and Yatseniuk is not sufficient to form a parliamentary majority. But the "majoritarian" part of mixed electoral system may significantly improve the overall electoral result of pro-presidential forces.

«Batkivshchyna» started its electoral campaign

Yulia Tymoshenko's political party will base its electoral campaign on popular issues of lustration, introduction of new people into politics and fight against oligarchs' rule.

Having reorganized itself, "Batkivshchyna" launched a visual campaign "We have begun lustration with ourselves". From a technological point of view, it is a successful continuation of public discussion on the need for the change of political elite and the adoption of the draft law "On the purge of the government".

Yulia Tymoshenko was fully aware that the exit of Yatseniuk-Turchynov from «Batkivshchyna» would weaken the party position. The political council of "Batkivshchyna" voted for the preservation of the united party. Thus, she fore-

"Batkivshchyna" will base its electoral campaign on popular issues of lustration, introduction of new people into politics and fight against oligarchs' rule

stalled the attempts of Yatseniuk and Turchynov to leave the party and promised to support Yatseniuk as prime minister during the formation of a new coalition after parliamentary elections. "Batkivshchyna" also supported the idea of coalition with other democratic pro-European parties in the next Parliament. Arseniy Yatseniuk and Oleksandr Turchynov found themselves in a difficult position — a number of their demands were fulfilled, nevertheless, the decision to leave the party had already been taken. It considerably limits Yatseniuk's room for manoeuvre, as his behaviour will be publicly perceived as a demonstration of excessive political ambitions. In its turn, it will decrease the public approval ratings of his future political party if Yatseniuk decides to run for elections separately. As a result, Yatseniuk has no choice but to accept Poroshenko's terms as to the joint political bloc.

Tymoshenko's actions limit room for manoeuvres by Yatseniuk

The aim of the publication is to provide objective information on current political events in Ukraine and thorough analysis of major tendencies in domestic politics. Such analysis will assist in setting priorities in the process of implementing reforms in Ukraine and in evaluating quality of state decisions from the viewpoint of their impact and sustainability. Special attention is paid to evaluation of political competition in Ukraine and ability of key political players to address challenges.

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